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ABSTRACT

The systems of finance and governance of California's state universities and colleges and its community colleges have differed significantly. While the four-year institutions have been funded from the state budget, prior to 1978, the community colleges depended largely on local property taxes for revenue supplemented by state apportionments to redress imbalances between poor and wealthy districts. Proposition 13 drastically altered community college financing by reducing property tax revenues, mandating county- rather than districtwide collection of property taxes, and eliminating the district's authority to set or alter tax rates. Senate Bill 154 (SB 154) implemented a "target budget" approach in 1978-79 to mitigate the community colleges' immediate financial crisis. Later, Assembly Bill 8 (AB 8) sought to alleviate the rigidities of SB 154, return to enrollment-based funding, and maintain local control over budgets and expenditures. While AB 8 has generally been an effective measure, certain concerns, which have been recognized by the Assembly Education Committee, remain. These involve: (1) statutory versus budget-act approaches to community college finance; (2) free flow of students between districts; (3) the financial implications of program changes; (4) the effectiveness of incremental cost funding; and (5) the community colleges' overall mission in times of limited state resources. (The paper presents the position of the California Postsecondary Education Commission on these issues.) (HB)

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director's report

california postsecondary education commission

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MAJOR ISSUES IN COMMUNITY COLLEGE FINANCE

Summary of Testimony Presented to the
Assembly Education Committee

October 16, 1980

Mr. Chairman and members of the Assembly Education Committee, I am Pat Callan, Director of the California Postsecondary Education Commission. I appreciate your invitation to review the major state-level issues of Community College finance. Today, I shall describe the evolution of statewide formulas for the support of current operations at the California Community Colleges within the context of the State's approach to funding for all the public segments of postsecondary education. Then, I shall describe the changes in Community College finance caused by Proposition 13 and the consequences of those changes for future financing policies. Finally, I shall discuss the specific issues identified in your letter of October 1.

HIGHER EDUCATION FINANCE IN CALIFORNIA

The governance and finance system for California's public four-year institutions has traditionally been quite different than that for the two-year Community Colleges.

Since their founding, the University of California and the California State University and Colleges have been considered State institutions, receiving no funds from local property taxes. As systems of campuses under single governing boards, the University and the State University have been subject to the State's annual "budget cycle." Each October these segments estimate their base budgets as a statewide total for the current year, calculate baseline adjustments by negotiating inflation increases with the State, and request program/budget enrichments, including requests for cost-of-living adjustments in salaries. Customarily, the Governor and the Department of Finance reduce these enrichments substantially. The Governor's single amount per segment becomes its line item in the budget bill, which then winds its way through the legislative process until adopted in June and signed by the Governor.

Approximately 60 percent of the State's funds are provided for instruction, which is based on enrollment formulas--a faculty/student ratio of 17.5 for the University and 17.8 for the State University. Support for other activities at the University and the State University is presented in the Governor's Budget through a Program Classification System that identifies employee positions and funds for Research, Public Service, Academic Support, Student

Service, Institutional Administration, Physical Plant Operations, Student Financial Aid, and Independent Operations. Cost-of-living increases for salaries are provided at a fixed, statewide percentage and are applied to uniform salary schedules among the University's nine campuses and among the California State University's nineteen campuses.

The finance system for the Community Colleges has differed significantly from that of the other public segments. Before Proposition 13, each of the seventy Community College districts was authorized to levy a general purpose tax and several "permissive" taxes (primarily for community service and capital outlay) on the property tax rolls of the district. Basically, the maximum tax rate was the district's general purpose rate, established by the Legislature and adjusted by increases in the adult population and changes in the Consumer Price Index. Because district wealth varied widely, the local revenues per student also varied significantly, though not as much as among public school districts. To redress this imbalance, State apportionments before Proposition 13--roughly 35 percent of the total income for the colleges--were designed to equalize the income per student among districts by distributing more dollars to "poorer" districts than to wealthy ones. Even so, the highest-income district above 3,000 ADA in 1977-78 spent roughly twice the amount of the lowest-income district above 3,000 ADA. In retrospect, the State's equalization efforts before Proposition 13 were not effective.

In contrast to the standard program classification budgeting of the four-year segments, the State's apportionments to the Community Colleges were distributed in general grants tied only to each district's ADA. After combining these apportionments with property tax revenues, local boards of trustees enjoyed substantial latitude in allocating the funds among most campus activities, including salary levels and salary schedules that varied widely among the districts.

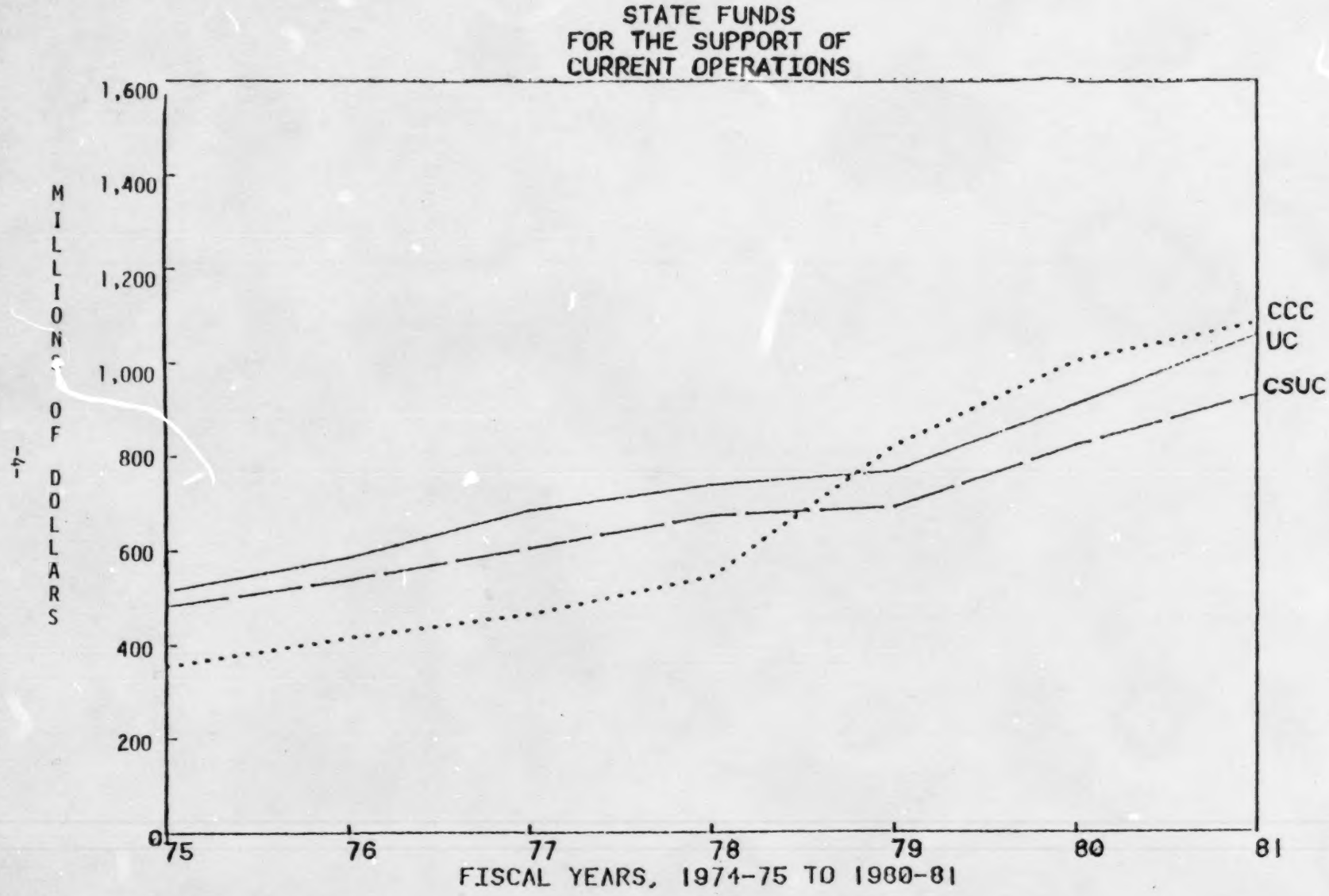
Proposition 13 drastically altered that system, not only by reducing property tax revenues, but also by making their collection countywide rather than districtwide, and by eliminating each district's authority to set its tax rate and to raise or lower that rate based on local circumstances. This local levy was the core support for the colleges, because State apportionments had been based on the relative ability and willingness of districts to tax themselves. By making the Legislature responsible for distributing property tax revenues, Proposition 13 destroyed the core of the finance system.

RECENT APPROACHES TO COMMUNITY COLLEGE FINANCE

To meet the immediate crisis of Community College finance for 1978-79, the Legislature agreed in SB 154 to distribute the regular State apportionments projected for that year ($537 million) without regard to enrollment. In addition, the Community College districts received $260 million from the State's surplus, which was distributed according to a "target budget" approach. Before determining how much each district would receive from the surplus, its individual budget was calculated by adding its projected State apportionments, a certain percentage of its reserves (this came to be a small $20 million statewide), and its projected revenues from the remaining property taxes. Then, each district received enough of the $260 million to reach 85 percent of its 1977-78 budget, adjusted upward by 6.8 percent for inflation. Larger property tax revenues than originally expected meant that each district in 1978-79 received roughly 95 percent of its 1977-78 revenues in actual dollars.

Although the "target budget" approach immediately after Proposition 13 allowed districts to maintain most of their traditional discretion in budgeting, the Legislature did impose some significant restrictions. Districts could not use State apportionments to support certain noncredit courses, primarily recreational and avocational offerings. Districts had to maintain a proportional level of service (85 percent of 1977-78 funding) in a dozen different programs the Legislature considered of prime importance. The Chancellor and the Community College system was authorized to distribute up to $15 million of the apportionments to insure that all colleges would remain open and that fiscal emergencies could be averted. Finally, no State funds would be available to districts that provided cost-of-living salary increases to their employees, a provision later declared unconstitutional by the State Supreme Court.

In sum, the State's approach to Community College finance in SB 154 was a hybrid. It was heavily influenced by the pattern of funding for the public schools, rather than by the pattern of the four-year segments. It reflected an unwillingness to shift property tax distribution at that time, a desire to maintain local governance, an insistence on statewide policies for salary adjustments, and a desire to protect certain legislative priorities. Most significant, the "bail-out" increased the State's proportion of Community College revenue up to 70 percent, even though the colleges received less total income for 1978-79 than for the previous year. This catapulted the Community Colleges from third to first among the three segments in terms of State revenues for current operations, as shown in the following chart.



California Postsecondary Education Commission
October 14, 1980

ASSEMBLY BILL 8

Assembly Bill 8 was the Legislature's response to the crisis of Community College finance and the rigidities of the "target budget" approach of SB 154. The major purposes of AB 8 for the Community Colleges were as follows:

1. Return the Community Colleges to enrollment-based funding;

2. Provide a two-year experiment through a sunset provision of June 30, 1981;

3. Alter the State's approach to funding enrollment change to provide fewer fiscal incentives for growth;

4. Remove certain funds from the general apportionments (such as capital outlay matching funds and child care support) and make them categoricals;

5. Provide more equalization in revenue per ADA than under previous financing arrangements; and

6. Establish a maximum State appropriation for the Community Colleges statewide, in order to limit the State's obligation.

We believe that, for the most part, AB 8 has been an effective response to the realities of post-Proposition 13 finance in recognizing the State's interest in equalization, funding limits, and priority programs, and in recognizing the need to provide some predictability for districts and to maintain local control over budgets and expenditures.

However, we have certain concerns. I shall identify some of these in responding to the specific issues raised in your letter of October 1.

ISSUES IDENTIFIED BY THE ASSEMBLY EDUCATION COMMITTEE

I. Your first question involves a statutory versus budget-act approach to Community College finance.

We believe that the general appropriation for the Community Colleges should be part of the State's annual budget act. The old finance system, which provided a guaranteed amount and annually increased that by a fixed adjustment, cannot adapt easily to unanticipated changes and does not clearly identify policy issues for the Legislature and Governor. The amount of

State dollars for the Community Colleges is now larger than the State's General Fund support for the University or the State University. Therefore, the statewide level of support for the Community Colleges must be reviewed annually to ensure equitable funding for all students in public higher education.

This does not mean that all funding provisions should be removed from the statutes and annually negotiated in the budget act. It is appropriate for the following components to be specified in statute:

- the kinds of courses and activities which will be supported by the State;
- the general method for funding enrollment changes; and
- statements of legislative intent regarding equalization and funding priorities.

Nevertheless, we believe that the total dollars for the Community Colleges, especially the annual increases for inflation, should be an issue in the State's budget process.

II. The second issue which you identified is the free flow of students between districts.

The realities of post-Proposition 13 finance and the energy crisis offer strong justification for the principle that students should be able to attend the Community College of their choice. Since the State determines virtually all income for the colleges, (both property tax distribution and general apportionments) it is difficult from a fiscal standpoint to deny students access to a college solely because of district boundaries. Further, AB 8 provides apportionments on the basis of "Attendance" ADA. This is a significant change from former policies wherein the district in which a student resided would receive the State's apportionment for that student even if the person attended college elsewhere. This earlier system led to elaborate contracts of repayment among districts and serious restrictions on student choice. Today, the State's funds flow directly to the district of attendance, and many districts have abandoned the contracts and the restrictions. We understand that San Diego and Orange Counties have recently liberalized provisions for crossing district boundaries. "Free flow" would seem to be an idea whose time has come; the challenge remains to work out the details.

There are at least two important details. First, there is a tendency for newer institutions, sometimes called "magnet" campuses, to attract more students than their older counterparts with less attractive facilities. This could result in substantial demands for new construction on certain campuses while others have unused space, a major problem now that the State is providing most of the funds for construction. Second, "free flow" does pose a problem for older, inner-city schools in a few areas. These problems can likely be alleviated by attention to these schools' special needs and by enhancing their particular programs.

III. Your third issue is the role of a program-change-proposal process for local colleges.

AB 8 calls on the Board of Governors to review annually the need for State funds, and "to provide for Community College district program changes which exceed those otherwise provided" in the law. This provision recognizes the difficulty of developing a statewide formula for all seventy districts which can, year after year, recognize and accommodate all the changes and exigencies. It also offers a leadership role for the Board of Governors, which is asked to identify special circumstances among the districts and to bring these to the attention of the Legislature.

We have been surprised that no change proposal under this AB 8 provision has been submitted by the Board of Governors. This is a well-established procedure for the four-year institutions, and one which can serve the unique situations of a few districts with special circumstances beyond the general formula's scope.

IV. Your fourth issue is the effectiveness of incremental cost funding.

The concept of incremental or "marginal" cost funding is sound. Any producer of goods and services, whether public or private, incurs certain "fixed costs" regardless of the operation's size: buildings must be maintained, utility bills paid, and the management structure must function to some degree. The <u>total cost</u> of an educational institution is the sum of these "fixed costs" plus "variable costs" (those directly related to the size of the student body). The <u>average cost</u> of education is the total cost of all campus activities related directly or indirectly to instruction, divided by the number of students. The <u>marginal cost</u> or <u>incremental cost</u> represents the dollars necessary to instruct additional students.

Average cost is high initially since an institution must staff up to some "critical mass" of instructional programs and student services before any students can be admitted. Then, the cost of adding students is nominal because they fill existing programs and courses. Also, these students place only small additional demands on librarians, counselors, and other support staff. As the college grows, however, the courses and programs are filled and entirely new programs and services must be established. This means high "costs" for those students added just above a certain enrollment level. After the new programs and services are in place, the marginal costs are reduced until the need to expand again becomes compelling. So, costs rise quickly, reach a plateau, and rise quickly again as more and more students are added.

Average-cost funding offers little recognition of these "step functions" or "plateaus." When enrollments are increasing, average-cost funding provides substantially more resources than are necessary for the new students. Likewise, unintentional and severe consequences occur when a formula subtracts the average cost per student if an institution steadily loses enrollment.

It is not in the State's interest to withdraw resources abruptly from educational institutions: tenure and contracts make deep retrenchment legally difficult in the short term, and the State's priorities may make it unwise. Once begun, a downward spiral can become self-reinforcing: fewer students attend an institution; courses are cancelled; even fewer students attend; and the college develops a bad "reputation." Innovative programs and community outreach often are the first casualties in this spiral, thus undermining certain State priorities. Ethnic and racial minorities and women are clustered in campus jobs most susceptible to layoffs and may suffer the brunt of personnel retrenchment. These concerns are <u>not</u> meant to imply that the State should completely insulate its institutions from any retrenchment if enrollments fall steadily or sharply. We do believe, though, that funding by average cost can initiate such large reductions that State policies are jeopardized and the institutions unjustly damaged.

Before AB 8, the State's policy was to fund enrollment changes at roughly each district's average expenditures per ADA. This was not a realistic measure of the cost per additional student, and provided unwarranted incentives for growth and unrealistic reductions for enrollment declines. AB 8 provides revenues equal to two-thirds of the statewide average revenue per ADA for enrollment <u>growth</u>, and reduces revenues by two-thirds of the district's revenues per ADA for enrollment <u>declines</u>.

Although we have only one year's experience with this new provision, we believe that the two-thirds incremental rate is an effective mechanism. The actual statewide ADA for 1979-80 was only .4 percent higher than projections, indicating no serious errors in the statewide estimating process. The Chancellor's Office, in a recent study, found that the incremental feature was "reasonable." Further, the two-thirds amount is within the broad range used by other states: a study of the Texas formula suggests that 50 percent of the average student cost is a realistic reduction for enrollment losses while Indiana uses 73 percent as its incremental rate for enrollment declines of 2 percent. We believe the incremental rate in AB 8 should be continued until and unless a demonstrably better approach is found.

V. Your final issue concerns the overall mission of Community Colleges in times of limited State resources.

In responding to this general concern, it is important to recognize that instructional activities of the colleges are changing on many campuses now, not under the auspices of a State mandate but because of funding limitations. Because of a 5 percent decline in each district's total revenues during 1978-79, all districts had to establish instructional priorities and make difficult decisions. Community services, previously funded through a permissive property tax, were reduced substantially in most districts after Proposition 13 and eliminated in some. One-fourth of all part-time faculty were laid off in 1978-79, according to a survey conducted by the Chancellor's Office. It is safe to conclude that the emphasis is changing on most Community College campuses now, although neither the extent nor the nature of these changes is uniform.

One important development with regard to the mission of the Community Colleges is a recent study of noncredit courses submitted by the Chancellor's Office. All noncredit courses that qualified for State funding in 1977-78 were eligible for support in 1979-80, under AB 8. In turn, the Chancellor was directed to conduct a study and recommend policy on the determination of credit and non-credit courses. He has submitted that report to the Legislature and the Commission, and we will soon be forwarding our comments and recommendations on it.

The Chancellor's report contains an extensive Classification System as a description of the instructional and community services of the California Community Colleges. The Commission staff agrees that this Classification System is more fully

descriptive of the comprehensive Community College than are the commonly used and very general categories of transfer, occupational, developmental, and general education courses and community services. Therefore, the new Classification System is potentially useful to State officials and others who must make decisions about Community College functions and funding.

We also agree with the report's recommendation of full funding for Community College courses which have been reviewed and approved locally and by the Chancellor's Office in accordance with appropriate provisions in the Education Code. Generally, these fall within the Instructional component of the Classification System. It is unlikely, however, that the State will be able, or willing, to provide full funding to enable the Community Colleges to meet all the needs of all the adults in their communities for continuing education programs which are within the scope of the Classification System. In order to retain open-door admission policies and to maintain the present quality of instructional offerings, the Board of Governors needs to identify statewide interests and priorities, consistent with its Long-Term Finance Plan. At the same time, local boards of trustees will need to establish priorities for State-funded offerings in the Classification System, tailored to meet specific local needs and priorities. In addition, we are recommending that there be partial State funding for community services, with the remainder of the funding to come from user fees and private sources. We do not believe that these changes will alter the fundamental mission of the Community Colleges, but they will require that priorities be established for State-funded operations within fiscal realities.

Mr. Chairman and members, I appreciate this opportunity to discuss the important issues of Community College finance.

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